



Department of Insurance

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REGULATORY BULLETIN 2006-06¹

TO: Insurance Rating Organizations Insurance Industry Representatives; Insurance Trade Associations; Property & Casualty Insurers; and, Other Interested Parties

From: Christina Urias
Director of Insurance

Date: July 25, 2006

RE: Private Passenger Automobile Insurance Grace Period Provisions

The Arizona Department of Insurance ("Department") administers Arizona Revised Statutes ("A.R.S."), Title 20, Chapter 6, Article 11, Section 20-1632.01. This Section requires insurers to provide private passenger automobile insurance policyholders a minimum seven (7) day grace period for the payment of any premium due except for the first payment. During the grace period, the policy must continue in full force without penalty even though the policyholder has not paid the premium due. The Department's market conduct examinations and consumer complaints indicate that violations of Title 20 grace period law are common occurrences.

Prior to passage of A.R.S. §20-1632.01 in 1987, insurers generally set premium due dates on any date of their choosing; typically 45 days or more before the policy would be at risk for cancellation due to lack of unearned premium available to pay for the continued coverage. When policyholders failed to pay the required premium by the specified date, the insurers cancelled the policy for non-payment of premium and refunded the unearned premium on hand at the time they sent the premium due notice. The legislature enacted A.R.S. §20-1632.01 to ensure that the insurers would not cancel policies for non-payment of premium while the insurer still held premium available to pay for this coverage up to a date certain *and* for seven (7) days thereafter. The statutes apply similar grace period provisions to individual, group, industrial and variable life insurance, individual, group and variable annuities, and individual health policies.

The term "grace period" is consistently used in a wide variety of settings to refer to some period of "grace" wherein the individual is not penalized for failing to do something, or where the

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person receives something of value that they would not otherwise be entitled to receive, but for the grace of the person to whom the duty is owed. Under this definition, an insurer only provides a grace period if it continues to keep the policy in force despite the fact that the insurer does not hold any unearned premium to pay for coverage afforded during that time period. In other words, a grace period cannot run during a period for which the insurer still holds unearned premium. The policy would remain in force by virtue of the fact that the insurer holds sufficient premium to provide coverage under the policy for the specified time period; not because of any required grace period. Under this analysis, and in order to comply with this law, the grace period cannot begin to run until 12:01 a.m. of the day *after* the last day through which the insurer has earned **all premium** held. Further, the statute requires a “minimum grace period of seven days” or seven (7) full 24-hour periods. Thus, an insurer cannot cancel a policy earlier than 12:01 am on the eighth (8th) day.

An insurer **may** issue a premium due notice to the insured requiring the insured to pay premium prior to the date on which the insurer has fully earned all premium held. The insurer **may not** calculate the grace period to run during the period the insurer continues to hold premium. For example, if an insured renews his policy and pays in full for the period of 11-15-05 through 5-15-06, the grace period does not begin to run until 12:01 a.m. on 5-16-06. The insurer may set a 5-8-06 premium due date for the renewal of 5-15-06 through 11-15-06, however, the insurer may not calculate the grace period to run from 5-9-06 through 5-15-06 because the insurer already holds premium to pay for coverage during that period.

While an insurer may set premium payment dates as part of its normal billing practices, it cannot cancel a private passenger automobile policy without affording the insured a minimum seven (7) day grace period. During that grace period, the policy remains in full force without penalty even though the insurer does not hold any premium to cover the risk. Anything less does not constitute a grace period within the meaning of the law. If the insured fails to pay the premium or mail the payment within the grace period, the insurer can cancel the policy for non-payment of premium on 12:01 am on the eighth (8th) day. Although the law requires insurers to continue the policy in full force during the grace period, once the grace period expires and the insurer cancels the policy, the insurer may bill and collect from the insured any premium due for coverage afforded during the grace period.

An insured's attempted payment of premium due with an NSF (insufficient funds) check will not constitute payment within the grace period. While insurers should promptly notify the insured that the bank returned the check for insufficient funds, policyholders bear full responsibility for knowing whether or not there are sufficient funds to cover checks they write. The grace period is not extended even in the event the policyholder may not receive formal notice of the dishonored check until after the grace period expires and the insurer has cancelled the policy.

An insurer may not backdate the effective date of policy cancellation if the insurer does not receive, or the premium payment is not postmarked, within the grace period. The insurer must provide coverage through the grace period. If one interpreted the law to permit the insurer to backdate the cancellation effective date, it would mean that the insurer never actually provided the coverage during the grace period as the law requires. In addition, backdating the cancellation date could result in the wrongful denial of claims that occurred during the grace period. The insurer must accept, investigate and pay claims occurring during the grace period in the same manner as a claim made during a period for which the insured has paid the premium. If a claim arises within the grace period for which the insured had not yet made a payment, the insurer may deduct the amount of the premium owed from any amount payable to the insured in settlement of the claim.

Insurers may cancel or non-renew a policy for nonpayment **after** the grace period expires by mailing a notice to the policyholder via first class mail. The notice must include the insurer's basis for the action and notify the insured of his/her right to complain to the Director. The cancellation must be effective on the date it is mailed **or** upon a later date as stated in the notice. If an insurer elects to provide the policyholder with additional time to pay the premium beyond the seven (7) day grace period, the notice must clearly and unequivocally express the insurance company's intention to cancel the policy. Extending the time to pay the premium in this manner does not establish a new premium due date necessitating an additional seven (7) day grace period, nor does it require a subsequent cancellation notice if the insured does not pay the premium by the extended date.

Please note that insurers cannot represent to their insureds that the payment receipt date is the critical date and that their policy might not continue in force if the insurer does not *receive* payment by a specific date. A.R.S. §20-191 requires insurers to use the postmark date if they retain the envelope, or establish the mail date as five days prior to receipt, if the envelope is not retained or the postmark is unreadable. Therefore, payments postmarked (or deemed postmarked) within the grace period are timely received.

As noted in the ADOL's 2nd Quarter 2004 Insurance Regulator newsletter "the insurer's duty to afford coverage during the grace period is unconditional and absolute."

If you have any questions regarding this matter, please feel free to contact Catherine M. O'Neil, Consumer Affairs Division, at (602) 364-2496.